ESTATE MATTERS

Avoiding estate planning pitfalls

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Estate planning presents many potential pitfalls. Recent developments have again shown how important it is to revisit your plans frequently to ensure they remain relevant. Relegating your will to the proverbial bottom drawer once it has been drafted is probably one of the biggest mistakes you can make.

Changes introduced in the Budget

The recent Budget delivered by then-Finance Minister Pravin Gordhan is a case in point. It has introduced a number of additional punitive taxes aimed at the rich and has a direct impact on existing estate planning ideas.

Key changes to the Budget include:
- taxable income above R1.5 million will be taxed at a higher marginal tax rate of 45%
- the effective capital gains tax (CGT) rate for individuals and special trusts has increased to 18%
- the effective CGT rate for other trusts has increased to 36%.

These changes, together with the introduction of section 7C of the Income Tax Act (which deals with interest-free loans), have prompted many clients to ask if it is still worth holding a property in a trust. Unfortunately, it is not as simple as transferring the property and closing the trust.

Interest-free loans to trusts

Parliament accepted the recommendations of Judge Davis's commission of enquiry into taxation reform in January this year. As a result, the newly drafted section 7C has been introduced to the Income Tax Act with effect from 1 March 2017. This section deals with interest-free loans to trusts and has had a major impact on estate planning. Specifically, it has considerably challenged the continued use of trusts as estate planning structures.

The legislation applies to any loan made by a natural person to a trust. If the interest charged on the loan is less than the repo rate plus 1% (currently, this would be 8%) the difference will now be a deemed donation. This deemed donation will be subject to 20% donations tax, although the annual donations tax exemption (currently R100 000) will continue to apply.

Transferring immovable property from a trust

The practical implication of the change is that unless there are other compelling reasons to retain the trust, it is probably a better option to transfer immovable property into the name of the individual who made the loan to the trust. Doing so will reduce or extinguish the loan account. However, since section 7C also provides an exemption if the loan to the trust is made for the purchase of a home for the lender, this should only be considered if a loan has been made to fund a second or an additional home.

The impact of transfer duty

Normally, transferring property from a trust will attract transfer duty, conveyancing fees and CGT. The Transfer Duty Act, however, allows for an exemption from transfer duty if the transfer is made to a beneficiary of the trust within the third degree of consanguinity of the founder of the trust (i.e. to a close relative like a grandchild, child or nephew or niece), and provided that nothing is paid for the property.

You can therefore transfer the property into the name of the relative and deregister the trust. However, the transferee, founder and the transfer itself all need to meet the requirements of the Transfer Duty Act for the exemption to apply.

Selling the property in the future

Another point to consider is the future sale of a property and the related impact of CGT if it is held in a trust. Property will attract CGT at an inclusion rate of 80% of the gain, which will be included in the taxable income of the trust. This is then taxed at 45% and, unlike in the case of a natural person, no annual rebate applies.

Trustees may, however, depending on the provisions of the trust deed, use the conduit principle to award the capital gain to any or all of the beneficiaries of the trust. This will help to ensure that the inclusion rate is reduced to 40% and the annual rebate of R40 000 is applied.

There is not a 'one-size-fits-all' solution

This is a complex matter and you should consider the impact of transferring assets from a trust, or deregistering a trust, holistically. It is important to consider each person's unique circumstances and to structure their estate plan accordingly.

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Effective estate planning starts by discussing the relevant issues with a Fiduciary Practitioner of South Africa, the highest designation awarded to estate practitioners by the Fiduciary Institute of Southern Africa.

Your fiduciary adviser will only be able to identify potential shortcomings in your existing will or estate plan and provide appropriate guidance and solutions once they understand your unique circumstances. Good communication is therefore the cornerstone of this process and estate owners need to be clear about their needs when engaging with their fiduciary practitioner.